

New TCJA Reporting Rules For Life Settlement Transactions

By **Brian Casey, Jaremi Chilton and Thomas Sherman**
(April 24, 2018, 2:28 PM EDT)

This is the first article in our series of three articles addressing the material impacts of the Tax Cuts and Jobs Act to the U.S. life settlements industry. In this article we examine the TCJA's new Internal Revenue Service informational reporting requirements for investors' acquisition of in-force life insurance policies in the secondary trading market and for life insurers' payments of death benefits for secondary life insurance market policies.

Federal Income Tax Basis for Life Insurance Policy Seller

One major TCJA change is the legislative repeal of certain instructions relating to Situation #2 of Internal Revenue Service Revenue Ruling 2009-13, which had required the original policyholder seller of a life insurance policy to deduct from his or her income tax basis in the policy the cost of insurance element in the premiums paid for the policy, thereby inflating the amount of taxable gain required to be recognized by the seller upon the sale of the policy in a life settlement transaction. This revenue ruling put sellers of life insurance policies in an tax adverse position compared to policyholders that surrendered their policies to life insurance companies for cash surrender values. This change, which has a retroactive effective date of Aug. 25, 2009,[1][2] no longer requires a reduction in tax basis for "mortality, expense or other reasonable charges incurred under an annuity or life insurance contract."

IRS Reporting of Life Settlement Transactions and Death Benefit Payments

The TCJA impose a new reporting requirements regarding certain life settlement transactions, now defined under the Internal Revenue Code as "reportable policy sales," and payments of the death benefits of life insurance policies which have been the subject of a reportable policy sale. Such associated death benefit payments are now defined under the IRC as "reportable death benefits".[3]

These new reporting requirements apply to all reportable policy sales after Dec. 31, 2017, and all reportable death benefits paid after Dec. 31, 2017.



Brian Casey



Thomas Sherman



Jaremi Chilton

A reportable policy sale is defined as “the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer’s interest in such life insurance contract. Practically, this means the purchase of a life insurance policy by a person that does not have an insurable interest in the life of the individual whose life is insured under the policy. For purposes of the preceding sentence, the term ‘indirectly’ applies to the acquisition of an interest in a partnership, trust or other entity that holds an interest in the life insurance contract.”[4]

A reportable death benefit is defined as “amounts paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale.”[5]

The new IRS reporting requirement that mandates life insurance companies file returns with the IRS for reportable death benefits paid after Dec. 31, 2017, may create a conundrum for life insurance companies that pay death benefits after Dec. 31, 2017, for a policy that was the subject of a reportable policy sale before Dec. 31, 2017. For a reportable policy sale before Dec. 31, 2017, the life insurance company may not know if there has been a reportable policy sale (unless the sale was a regulated secondary transaction and the life settlement provider notified the insurer of the sale as required under most states’ life settlement acts or there was another change in policy ownership form filed with the insurer in connection with another transfer of the policy). However, a conservative approach for a life insurance company in this circumstance is to assume that unless the original owner still owns the life insurance policy at the time the death benefit is paid to the beneficiary named in the life insurance policy (particularly if the original beneficiary has been changed), a prior reportable policy sale occurred.

Reportable Policy Sale Reporting Requirements

The first report triggered by a reportable policy sale is a report to the IRS by the acquirer/purchaser of a life insurance policy or an interest in the policy where that purchaser does not have an insurable interest in the life of the insured under the policy. Thus, when a life settlement provider acquires a policy in a regulated, “secondary” transaction from the original owner, the life settlement provider must file a report for the purchase of the policy with the IRS for the taxable year in which the purchaser acquired the policy (or indirect interest in the policy, including the death benefit payable under such policy), at such time and in such manner as shall be determined by the IRS. The IRS is now developing the reportable policy sale reporting form and guidance for its preparation and filing in consultation with the American Council of Life Insurers, the primary U.S. trade association of life insurance companies and two U.S.-based life settlements industry trade associations, the Life Insurance Settlement Association and the Institutional Life Markets Association. Because this new tax reporting obligation is already effective, it is expected that the IRS will issue some form of guidance well before the end of 2018, but no such guidance has been provided as of the date of this article.

Timing of Filing of Reportable Policy Sales Returns

The language in new IRC Section 6050Y(a)(1) appears to require one annual report to be prepared and filed by each life insurance policy purchaser for all its reportable policy sale acquisitions during the preceding taxable year of such purchaser. “Every person who acquires a life insurance contract or an interest in a life insurance contract in a reportable policy sale during any taxable year shall make a return for such taxable year (at such time and in such manner as the Secretary shall prescribe ...)” If this does not mean a single “batch” return to be filed shortly after the end of a purchaser’s taxable year, then the alternative might be that a separate return must be filed with the IRS promptly after the completion of each reportable policy sale throughout the course of the year.

Who Must File Reportable Policy Sale

“Every person who acquires a life insurance contract or any interest in a life insurance contract...shall make a return.”

Direct Purchasers

Regulated or Secondary Life Settlement Transactions

A life settlement provider that acquires a life insurance in a regulated secondary transaction must file a reportable policy sale return with the IRS. Then, when the life settlement provider resells a policy to an investor, the investor purchaser of the policy must then file its own separate reportable policy sale return with the IRS. The investor's return would be the second reportable policy sale report filed in connection with a typical secondary life settlement transaction. Because most life settlement providers do not buy life insurance policies for their own accounts, but rather, using the investor's purchase money funds, buy a policy as the regulated purchaser and then immediately resell the policy to an investor[6], in effect, there will be two reportable policy sale returns filed for each sales step of the same life settlement transaction.

Tertiary or Unregulated Life Settlement Transactions

tertiary life settlement transaction is generally the sale by an investor of a life insurance policy which has previously been the subject of a secondary, regulated sale transaction. Once a life insurance policy has been transferred by the original owner in a regulated transaction, generally that life insurance policy, often described as a viaticated or life-settled policy, may be purchased from the policy's then owner (investor) without the requirement that the purchaser be a licensed life settlement provider. In a tertiary, unregulated transaction, the purchaser in that transaction must file a reportable policy sale return with the IRS.

Indirect Purchasers

Next, suppose that the investor purchaser from the life settlement provider is a limited liability company. That limited liability company, which has acquired an interest in a life insurance contract, must file a reportable policy sale return with the IRS. For members of that limited liability company at the time of the limited liability company's policy acquisition, no reporting requirement is likely to be triggered for those members, but future members of the limited liability company with no insurable interest in the life of the insured may have an IRS reporting obligation upon their obtaining membership status. In short, for every acquisition of a life insurance policy or an indirect or direct interest therein (including an interest in the death benefit payable under the policy), whether or not that transfer is recorded on the books of the insurer, where the transferee does not have an insurable interest in the life of the insured, that transferee/acquirer must file a reportable policy sale return with the IRS. In other words, any person that acquires a beneficial interest in a trust, partnership, limited liability company or other entity that owns a life insurance policy, or a fractional interest in a death benefit payable under a life insurance policy, assuming that person does not have an insurable interest in the life of the insured, is an 'indirect' acquirer of an interest in a life insurance contract and must file a reportable policy sale return with the IRS.[7]

Lender with Life Insurance Policy Collateral Assignment

Whether a secured lender, premium finance lender or otherwise, that acquires a security/collateral interest in a life insurance contract must file a reportable policy sale return with the IRS is an unanswered question, but the answer is likely to be no because the granting of a collateral assignment of a life insurance policy is not a transfer of a policy for value for purposes of Internal Revenue Code Section 101(a)(2).[8]

Securities Intermediaries Record Ownership of Life Insurance Policies for Investors

In connection with a variety of life settlement transactions, secondary or tertiary, there often is a securities intermediary (acting under Article 8 of the Uniform Commercial Code) that holds for its investor customer record ownership (and beneficiary rights) of a life insurance policy on the books and records of the issuing life insurance company. If a securities intermediary acquires an interest in a policy as the nominal owner of record for its investor customer, it is likely that the underlying beneficial owner (i.e., the investor and not the securities intermediary) with no insurable interest in the life of the insured must file a reportable policy sale return for the beneficial owner's indirect acquisition of the policy held by the securities intermediary for the beneficial owner's account but not for the account of the securities intermediary, which does not acquire an economic interest in the policy. In the reportable policy sale return form to be developed by the IRS there may be a line item to indicate that the securities intermediary holds only nominal, record title for the benefit of the beneficial owner investor. That, however, may create a "tension" among the beneficial owners/investors in life insurance policies under securities intermediary arrangements because frequently investors (such as hedge funds) prefer that their identities as policy investors remain confidential.

Retained Death Benefit Life Settlement Transactions

A retained death benefit life settlement transaction, which effectively is a sale of most but not all of the death benefit payable under a life insurance policy, occurs where the original owner of the life insurance policy sells that life insurance policy but retains the right to designate an irrevocable beneficiary for a portion (typically 10 percent or less) of the death benefit. For a retained death benefit life settlement transaction in which an original policyholder sells ownership of a life insurance policy but arranges for the policy's original beneficiary or a family member of the seller to retain the right to receive payment of a portion of the policy's death benefit after the sale of the policy, the retained death benefit beneficiary would not be an acquirer of a life insurance contract or any interest therein, so long as the retained death benefit beneficiary has an insurable interest in the life of the insured. Therefore, the retained death benefit beneficiary would not be required to file a reportable policy sale return with the IRS for this type of life settlement transaction, although, as discussed above, the life settlement buyer of the policy and the investor to which the policy is resold by the life settlement provider would need to file their respective reportable policy sale returns.

Off-Shore Purchasers

A U.S. domestic life settlements investment fund must file a reportable policy sale return for its acquisition of a life insurance policy, but an off-shore investment fund might take the position that the IRS has no jurisdiction over it, and accordingly, such off-shore fund may decide it is not be required to file a reportable policy sale return with the IRS.

What Information Must the Purchaser report to the IRS

IRC Section 6050Y(a)(1) requires reporting of the name, address and federal taxpayer identification number of the purchaser, the date of the policy's sale, the identity of the insurer that has issued the policy, and the name, address and taxpayer identification number of each recipient of a payment in connection with the policy's sale and the amount of such payment. In other words, all payments by or for the account of the seller and purchaser of the policy in connection with the reportable policy sale must be included on the return filed by the purchaser with the IRS. The recipients and the amount of payments would include the policy's sale price paid to the seller and fees paid to an escrow agent and any life settlement brokers representing the seller. These persons may include the life insurance agent who sold the policy to the seller as oftentimes these agents serve as an intermediary between their clients, the policy sellers and a wholesale life settlement broker that arranges for the agent of record to receive a commission or fee sourced from the life settlement proceeds. Theoretically, attorneys, accountants, actuaries or consultants that might have provided legal, accounting, pricing/premium optimization, policy servicing services to the purchaser, and the fees paid for their services, in connection with the policy's sale might also be persons identified on the purchaser's reportable policy sale return, but the reporting of these items is not likely what Congress intended. However, the policy origination fee paid by the purchaser of a policy to a life settlement provider for sourcing, buying and reselling a policy to an investor, whether in a secondary or tertiary transaction, should be reportable to the IRS by the investor.

In addition, IRC Section 6050Y(a)(2) requires the purchaser to provide to each person named in the purchaser's reportable policy sale return the information disclosed in the return about such person. The purchaser may have an option to provide a notice to a person of only that person's data in the return, or such purchaser may instead send a copy of the full return to that person, which would include the data of all persons listed in the return, as an easier method of satisfying this requirement, rather than creating a more cumbersome business process of plucking out each identified person's data and sending only that data to such person. However, all parties must be particularly careful not to disclose personal health or other personal identifying information to unrelated parties.

Life Insurer's Reporting Requirements to IRS

Upon the Receipt by the Insurer from the Purchaser of Purchaser's Reportable Policy Sale Return

Once a life insurance company receives a reportable policy sale return from a purchaser of a life insurance policy, the issuer of that policy must file a return with the IRS containing the name, address and federal tax identification number of the policy's seller and the policy seller's income tax basis of the policy (see below).

This reporting requirement may prove to be a significant burden for life insurers. Assuming each acquirer of life insurance policies issued by a particular life insurer must file only one annual reportable policy sale return for all such policies acquired during a taxable year, in a secondary market transaction there will be two reportable policy sale returns, one made by the life settlement provider for its purchase of a policy from its original owner and then one made the investor (if a domestic person) for its purchase of that policy from the life settlement provider. However, in a fractionalized death benefit scenario, where a limited liability company or partnership buys a policy for multiple (usually accredited retail) investors, there might be many more reportable policy sale returns required, one for each fractional investor (imagine a Life Partners situation where there might be 20 or more life settlement interest purchasers on a single policy).

Upon Life Insurer's Receipt of Notice of a Policy Transfer to a Foreign Person.

In addition, even in the absence of a reportable policy sale return filed with the IRS by a purchaser, a copy of which must be provided by that purchaser to the insurer, if the insurer otherwise obtains notice of a transfer of a life insurance contract to a foreign person, that knowledge also triggers a new IRS return filing requirement for the insurer.[9]

Life Insurer Must Report the Seller's Investment in Life Insurance Policy to IRS

IRC Section 6050Y(b) requires a life insurer to report the amount of a policy seller's income tax basis in a policy that is subject of a reportable policy sale transaction to the IRS and provide a copy of that report to the seller {and any other persons?}. IRC Section 72(e)(6) defines a policy seller's tax basis as follows: "Investment in the contract - For purposes of this subsection, the investment in the contract as of any date is (A) the aggregate amount of premiums or other consideration paid for the contract before such date, minus (B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws."

That reporting requirement on the surface may appear to be relatively simple and straightforward with respect to the tax basis of an original owner/seller of a life insurance policy and would be the total amount of premiums paid for the policy since its issuance. But that amount is less meaningful information and not reflective of the tax basis in a policy for the sale of a policy by a life settlement provider to an investor or the resale of a policy by an investor to another investor in a tertiary life insurance policy market sales transaction.

A life insurance company must also provide a copy of its return filed with the IRS to the seller of a policy. That means the policy seller will receive copies of two returns, one from its purchaser and then another from the life insurance company.

Life Insurers' Reporting Requirements to IRS for Payment of Reportable Death Benefits

IRC Section 6050Y(c)(1) requires annual reporting to the IRS by "every person" who makes a payment of a reportable death benefit. This includes life insurance companies and life settlements investment entities that distribute pro-rata death benefits to their owners, as well as securities intermediaries that are the record beneficiary of life insurance policies, receive death benefit payments and remit them to their investor customers.

The reportable death benefits payment return must include the name, address and federal taxpayer identification number of the person making the payment, that same information with respect to the payee, the date of payment to the payee, the gross amount of the payment and an estimate of the payee's investment in the life insurance policy — see below.

If a lender with a collateral assignment receives a death benefit under that assignment from the life insurance company, the identity of that lender and its receipt of a death benefit payment will now be disclosed by the life insurance company to the IRS. Then, assuming that the lender distributes to its borrower, the policyholder that granted the collateral assignment, any amounts received by the lender in excess of the amount of the loan payoff, the lender must file a return with the IRS with respect to the payment by the lender to the borrower of that portion of the death benefit.

The amount reported by the life insurance company for the estimate of the payee's investment in the life insurance policy would generally be the premiums paid under the policy since its inception.

However, as to security intermediaries that are named beneficiaries of policies for their investment customers and investment entities that own policies the amount of the investment in a policy may not be known by the life insurance company. In addition, for life settlement investors, tax basis, if that's what the IRS is looking for, isn't the amount of premiums paid for the policy since its inception; rather, a life settlement investor's tax basis is the purchase price it paid for a policy plus the premiums it paid after policy acquisition until its maturity.

Insurers must provide copies of their reportable death benefits returns filed with the IRS to their payees.

Brian T. Casey is a partner and co-chair of the regulatory and transactions insurance practice group at Locke Lord LLP in Atlanta, Georgia. Thomas D. Sherman is senior counsel in the firm's regulatory and transactions insurance practice group at the Atlanta office. Jaremi Chilton is an international tax partner at the firm in its San Francisco and Houston offices.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Section 13521 of the TCJA amending Section 1016(a) of the IRC. Sellers that sold policies before Jan. 1, 2018, can file amended income tax returns to obtain a tax refund, but only for income tax returns which were filed for taxable years ending no earlier than Dec. 31, 2014, because there is a 3 year period in which to file a refund request. So, despite the retroactive undoing of RR 2009-13 back to 2009, the TCJA does not offer any relief for policy sales that occurred between on or after Aug. 25, 2009, and or before Dec. 31, 2013, the date of RR 2009-13.

[2] Section 13521 of the TCJA amending Section 1016(a) of the IRC.

[3] IRS Form 1099 reporting requirements with respect to the payment of death benefits are technically unrelated to the new reportable death benefit reporting rules.

[4] Section 13522(a)(3)(B).

[5] Section 6050Y(d)(4).

[6] Indeed, in most life settlement transactions, the original, selling policyholder names the investor as the new owner and beneficiary of the policy, bypassing the recordation of the life settlement provider as the owner and beneficiary of the policy on the life insurance company's records.

[7] At some point, the indirect interest becomes too attenuated. For example, if a public company buys a key-man policy on its CEO's life, does every shareholder of that company's publicly traded stock acquire an indirect interest in that policy? If so, reportable policy sale returns would have to be filed daily as shares of the company trade.

[8] Treas. Reg. Section 1.101-1(b)(4) provides that a collateral assignment of a life insurance policy is not a transfer for value.

[9] Section 6050Y(b)(1).

